

BEFORE THE  
TENNESSEE STATE BOARD OF EQUALIZATION

*In Re:* Pittco, Inc. )  
 Personal Property Account No. P-147039 T-A ) Shelby County  
 Tax years 2002, 2003, 2004 )

INITIAL DECISION AND ORDER

### Statement of the Case

The subject property is presently valued for tax purposes as follows:

TAX YEAR	APPRAISAL	ASSESSMENT
2002	\$15,565,800	\$4,669,740
2003	\$13,816,300	\$4,144,890
2004	\$12,390,400	\$3,717,120

Pittco, Inc. (“Pittco”) filed appeals from the assessments for tax years 2002 and 2003 with the State Board of Equalization (“State Board”) on September 27, 2004.<sup>1</sup> Subsequently, on December 21, 2004, Pittco filed an appeal of the assessment for tax year 2004 with the State Board.<sup>2</sup>

The undersigned administrative judge conducted a hearing of this matter on October 28, 2005 in Memphis.<sup>3</sup> Pittco was represented by attorneys John B. Burns and William H. D. Fones, Jr., of Baker, Donelson, Bearman, Caldwell & Berkowitz, PC (Memphis). Assistant Shelby County Attorney Thomas Williams appeared on behalf of the Assessor of Property.

### Findings of Fact and Conclusions of Law

**Background.** Seldom does a commercial entity expect to accomplish its objectives without any employees, marketing, or advertising. Yet thus far, anyway, that has been precisely the appellant's *modus operandi*.

Pittco is an S corporation that is wholly owned by Memphis businessman J. R. (Pitt) Hyde III. Pittco has no paid personnel; it contracts with a corporate affiliate called Pittco Management, Inc. (“PMI”) for administrative, accounting, and other services.

<sup>1</sup>The appeals for tax years 2002 and 2003 were precipitated by back assessments/reassessments of the subject property in the amounts of \$4,642,170 and \$4,115,550, respectively.

<sup>2</sup>The values shown for tax year 2004 were determined by the Shelby County Board of Equalization upon its consideration of the taxpayer's complaint pursuant to Tenn. Code Ann. section 67-5-1407.

<sup>3</sup>At the request of counsel for Pittco, due to the common issues involved, all three appeals were consolidated for hearing. The parties filed post-hearing briefs on December 12, 2005 and responsive briefs on January 23, 2006.

On February 8, 2000, Pittco purchased a 1995 Canadair “Challenger” model airplane for \$18,120,000. Pittco purports to be in the business of leasing this executive jet, which is housed at the Memphis International Airport in a hangar owned by the company.

As explained by PMI President John Pontius (who is also an officer of Pittco), Pittco deals solely in so-called “dry” leases whereby the lessees are responsible for procuring the pilots, flight crew, and ground personnel necessary for operation of the aircraft. The lessees must also cover the cost of fuel and other direct flight expenses. However, Pittco is responsible for repair and maintenance of the airplane during the term of the lease. In addition, Pittco is obligated to carry physical damage, liability, and medical expense insurance; and each policy must name the lessee as an additional insured and waive any right of subrogation against the lessee.

Pittco has entered into five “master” leases of its one airplane, all of which are recorded with the Federal Aviation Administration (FAA). Three of the lessees are for-profit companies (Genotherapeutics, Inc.; AutoZone, Inc.; and Federal Express) in which Mr. Hyde is a stockholder; and one is a nonprofit corporation (Memphis Tomorrow) of which he is a director. The other lessee, Mr. Hyde himself, is the primary user of the airplane. According to Mr. Pontius, Mr. Hyde makes only personal use of this vehicle; and he does not claim any federal income tax deduction in connection with such use. Pittco, Mr. Pontius testified, was conceived by Hyde as a mechanism for spreading the cost of ownership of the airplane among the multiple users and minimizing exposure to personal liability.

Each master lease recites that “[t]he Aircraft is available for nonexclusive use by a qualified Lessee...under such terms and conditions as are mutually satisfactory to the parties.” The stated inducement for this agreement is “One Dollar and...other valuable consideration.” The specified term of the master leases is three years, subject to automatic renewal on a month-to-month basis. A separate agreement is apparently executed for each period of time when the airplane is actually in use by a lessee. Between flights, Mr. Pontius declared, the jet remains entirely under Pittco’s control at the airport (except when being serviced by the manufacturer). The voluminous flight logs in the record indicate that the airplane was idle on the assessment dates for the three tax years under appeal.

For his use of the airplane, Mr. Hyde pays an annual flat fee to Pittco. The other lessees are charged an hourly “market” rate. On January 1, 2002, Mr. Hyde contracted with Air Trans Con, Inc. (“ATC”) for “pilot and aircraft maintenance services” with respect to the airplane leased from Pittco. That agreement calls for Hyde to pay ATC a fixed fee of \$517,500 per year, regardless of the amount of services provided. Neither Pittco nor Hyde has any ownership interest in ATC.

Pittco has regularly reported the gross revenue from the leases of the company’s airplane on its Business Tax return. In addition, Pittco collects and remits sales tax on each of these transactions.

In tax years 2002 through 2004, Pittco duly filed the tangible personal property schedule required by Tenn. Code Ann. section 67-5-903 with the Assessor's office. Although various tools and equipment were listed, the multi-million-dollar airplane was not. On May 15, 2003, the Assessor notified Pittco that the subject account had been randomly selected for audit. A "Summary of Audit Findings" was mailed to the taxpayer on April 2, 2004. By far the most significant of those findings was that Pittco's airplane should have been reported in GROUP 4 (Aircraft, Boats and Towers). In an accompanying letter (dated March 11, 2004), Audit Manager Gwendolyn Cranshaw, CPA advised Pittco that:

If you do not agree with the **audit findings**, have questions or need additional information, please contact the auditor, Neill Murphy, CPA, at (901) 266-0020 within 20 days. If the auditor is not contacted, the **audit findings** will become final and the new values will be certified to the collectors. [Emphasis added.]

Mr. Fones responded to Ms. Cranshaw's letter on May 28, 2004, protesting that Pittco's airplane was exempt from ad valorem taxation as inventory held for lease. On or about August 20, 2004, the Assessor sent Pittco a copy of the certification of back assessment/reassessment of the subject property for tax years 2002 and 2003 based on the auditor's findings.<sup>4</sup> Only at that point, Ms. Cranshaw maintained at the hearing, did she consider the "audit findings" referred to in her letter of March 11, 2004 to be final.

**Contentions of the Parties.** Pittco contends that the back assessment/reassessment for tax year 2002 was untimely and therefore invalid. Moreover, Pittco maintains, its airplane is not assessable in any event because it is either: (a) inventory held for sale or exchange; or (b) if deemed to be in the possession of Mr. Hyde (the primary lessee), not used by him for commercial or industrial purposes and therefore deemed to have no value under Tenn. Code Ann. section 67-5-901(a)(3)(A).

Characterizing the audit findings mailed to Pittco on April 2, 2004 as "preliminary," the Assessor maintains that the deadline for making the back assessment/reassessment was tolled until the certification to the tax collecting officials of the additional amount allegedly due. On the substantive issue raised by these appeals, Mr. Williams asserted that: (a) Pittco is exempt from the Business Tax pursuant to Tenn. Code Ann. section 67-4-712(b); and (b) Pittco's purported leases of the airplane to Mr. Hyde and other entities in which he has an interest are actually loans or bailments.

**Applicable Law.** Article II, section 28 of the Tennessee Constitution provides that "all property real, personal or mixed shall be subject to taxation" unless exempted by the legislature. Further, "the Legislature may levy a gross receipts tax on merchants and businesses in lieu of

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<sup>4</sup>Presumably, the audit findings also formed the basis of the value determined by the county board of equalization for tax year 2004.

ad valorem taxes on the inventories of merchandise held by such merchants and businesses for sale and exchange.”

As defined in Tenn. Code Ann. section 67-5-901(b):

“Inventories of merchandise held by merchants and businesses for sale and exchange” includes tangible personal property held for sale or rental, but does not include such property in the possession of a lessee. Leased personal property in the possession of a lessee shall be classified and assessed according to the use of the lessee.

Consistent with the quoted excerpt from the state constitution, the General Assembly has expressed the intent that inventories of merchandise held for sale or exchange, which are taxable under the Business Tax Act, not be subject to ad valorem taxation.<sup>5</sup> Section 67-4-702(a)(10) of the Business Tax Act defines “lease or rental” as “the leasing or renting of tangible personal property and the possession or use thereof by the lessee or renter for a consideration, without transfer of the title of such property.”

Generally, except in the event of fraud, collusion, or non-reporting of personal property, a back assessment or reassessment of property must be initiated by the assessor of property by September 1 of the year following the tax year in which the original assessment was made.<sup>6</sup> Tenn. Code Ann. section 67-1-1005(a). However, during its 2000 session, the General Assembly amended the law by adding the following new subsection:

(d) Notwithstanding the deadline in this section for initiating a back assessment or reassessment, the issuance of a notice of tangible personal property audit by the assessor tolls the running of the deadline during the period of the audit from the issuance of the notice until issuance of the audit findings.

### **Analysis.**

Validity of Back Assessment for Tax Year 2002. When the notice of audit was issued to Pittco on May 15, 2003, the statutory back assessment/reassessment deadline for tax year 2002 (September 1, 2003) was less than four months away. Contrary to the Assessor’s insistence, the mailing of the “audit findings” to the taxpayer on April 2, 2004 undoubtedly marked the end of the tolling period under Tenn. Code Ann. section 67-1-1005(d). It is understood that the Assessor, acting in good faith, might later have agreed to change those findings upon receipt of sufficient justification. But section 67-1-1005(d) was surely not intended to give the Assessor an indefinite period within which to ponder audit findings and decide whether to initiate a back assessment or reassessment. As apparently construed by the

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<sup>5</sup>Section 67-4-702(a)(9) of the Business Tax Act contains a substantially identical definition of *inventories of merchandise held for sale or exchange*.

<sup>6</sup>A back assessment or reassessment of property is initiated “by certification...to the appropriate collecting officials identifying the property and stating the basis of the back assessment or reassessment and the tax years and amount of any additional assessment for which the owner or taxpayer is responsible.” Tenn. Code Ann. section 67-1-1005(b).

Assessor, the statute would have just that effect because issuance of the “audit findings” would coincide with initiation of the back assessment/reassessment itself.

Since the back assessment/reassessment for tax year 2002 was made over four months after the issuance of the audit findings, it must be dismissed. See, e.g., Park Avenue Radiology Associates, P.C. (Shelby County, Tax Years 2001 & 2002, Initial Decision and Order, November 1, 2005).

Assessments for Tax Years 2003 and 2004. In a dramatic change effective January 1, 1991, the legislature shifted the liability for the tax on leased personalty from the *lessor* to the *lessee*. See Public Acts, section 1075, section 2 and 14. Under the **prior** law, the “inventories of merchandise held for sale or exchange” exemption otherwise available to a lessor of tangible personal property was lost if:

- (A)(i) The lessor owns or controls more than ten percent (10%) of the lessee; or
- (ii) The lessee owns or controls more than ten percent (10%) of the lessor; or
- (iii) Any single entity owns or controls more than ten percent (10%) of the lessee; and owns or controls more than ten percent (10%) of the lessor; and
- (B) The lease results in actual use of such property by the lessee as opposed to holding such property for further resale or lease; and
- (C) The lessor generates ten percent (10%) or more of its total gross dollar volume of leases in this state with lessees who are under common control as covered in this section.

Tenn. Code Ann. section 67-5-901(b)(1).

The airplane in question would undoubtedly have been assessable to Pittco under the above provisions – whether or not its arrangement with Mr. Hyde was deemed to be a lease. By contrast, for better or worse, nowhere does the **current** law state that personal property is not exemptible as inventory held for lease if the purported lessor and lessee(s) of such property are under common control.

The Assessor claims that Pittco is exempt from the Business Tax on the premise that the company actually receives only \$1.00 per year in consideration under the terms of the purported leases. Yet, in each of the tax years under appeal, Pittco reported well over \$1,000,000 in “gross sales” on its Business Tax returns. The fact that the bulk of this revenue came from the owner of the company does not justify the conclusion that the money was never paid or received.

Finally, none of the cases cited by counsel for the Assessor seems to support the proposition that the arrangements between Pittco and the purported lessees are really loans or bailments. As Mr. Burns pointed out in his Response to the Assessor’s Post-Hearing Brief (pp. 2—4), in Nissan North America v. Haislip, 155 S.W.3<sup>d</sup> 104 (Tenn. Ct. App. 2004), the taxpayer was seeking to escape liability for both the property tax **and** the Business Tax. That is not the situation here.

Order

It is, therefore, ORDERED that the back assessment/reassessment for tax year 2002 be dismissed, and that the subject property be valued for tax purposes as follows:

TAX YEAR	APPRAISAL	ASSESSMENT
2002	\$91,900	\$27,570
2003	\$97,800	\$29,340
2004	As reported	As reported

Pursuant to the Uniform Administrative Procedures Act, Tenn. Code Ann. §§ 4-5-301—325, Tenn. Code Ann. § 67-5-1501, and the Rules of Contested Case Procedure of the State Board of Equalization, the parties are advised of the following remedies:

1. A party may appeal this decision and order to the Assessment Appeals Commission pursuant to Tenn. Code Ann. § 67-5-1501 and Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization. Tennessee Code Annotated § 67-5-1501(c) provides that an appeal **“must be filed within thirty (30) days from the date the initial decision is sent.”** Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization provides that the appeal be filed with the Executive Secretary of the State Board and that the appeal **“identify the allegedly erroneous finding(s) of fact and/or conclusion(s) of law in the initial order”**; or
2. A party may petition for reconsideration of this decision and order pursuant to Tenn. Code Ann. § 4-5-317 within fifteen (15) days of the entry of the order. The petition for reconsideration must state the specific grounds upon which relief is requested. The filing of a petition for reconsideration is not a prerequisite for seeking administrative or judicial review.

This order does not become final until an official certificate is issued by the Assessment Appeals Commission. Official certificates are normally issued seventy-five (75) days after the entry of the initial decision and order if no party has appealed.

ENTERED this 17<sup>th</sup> day of February, 2006.

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PETE LOESCH  
ADMINISTRATIVE JUDGE  
TENNESSEE DEPARTMENT OF STATE  
ADMINISTRATIVE PROCEDURES DIVISION

cc: John B. Burns & William H. D. Fones, Jr., Attorneys  
Baker, Donelson, Bearman, Caldwell & Berkowitz, PC  
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